No. 12,406

In the
United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

CLARK SQUIRE, Collector of Internal Revenue
Appellant,

vs.

SUMNER RHUBARB GROWERS' ASSOCIATION, a Cooperative Agricultural Corporation,
Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON

BRIEF FOR THE APPELLEE

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NOTICE OF CORRECTION

Notice is hereby called to the typographical error found in the conclusions of law on page 38 of the Transcript of Record in that in paragraph 3 of said page 38, the section set forth therein as 10 (1) should be 101 (1).

STATEMENT OF FACTS

The first six pages of the appellant's brief, down to "Statements of points to be urged," are substantially accurate in what is set forth therein.

To make the facts more complete the appellee desires to add the following statement of fact: The Sumner Rhubarb Co-operative is now, and, during the tax period in question, was set up for the purpose of assisting rhubarb farmers of the Sumner valley locality in handling, planting, packing, grading, storing, or delivering to market or to storage or to a carrier for transportation to market, agricultural or horticultural commodities. During the period involved in this suit, the co-operative was storing, delivering to storage and to market and to carriers for transportation to market, rhubarb grown by farmers who were all members of the association or organization. (R. 3), (R. 67), (R. 72), (R. 74), (R. 77).

QUESTIONS PRESENTED

It is believed that the questions presented can be more clearly set forth as follows:

1. Is the appellee, Sumner Rhubarb Growers' Association, a labor, agricultural, or horticultural organization, and as such exempt from social security tax?

2. Whether or not section 101 (1) of the Internal Revenue Code and 101 (12) are mutually exclusive.

3. Whether the service of all the Sumner Rhubarb Co-operative should be exempt from social security tax, for the reason that they were doing work defined as "agricultural labor", in section 1426 (h) of the Code, as amended.

ARGUMENT

Is Sumner Rhubarb Co-operative An Agricultural or Horticultural Organization?

(a) It is agreed that the appellee was included under Session Laws of the State of Washington for

the year 1913 as a co-operative. The statutes of Washington covering co-operative associations can be found in Remington's Revised Statutes of Washington. Section 3904 reads as follows:

> "CO-OPERATIVE ASSOCIATIONS — WHO MAY ORGANIZE—PURPOSES. Any number of persons, not less than five, may associate themselves together as a co-operative association, society, company or exchange for the transaction of any lawful business on the co-operative plan. For the purposes of this act the words "association," "company," "exchange," "society" or "union" shall be construed the same. .. '13, p. 50, sec. 1)"

The Sumner Rhubarb Co-operative was set up by farmers who grew rhubarb in the Sumner valley. The purpose of the co-operative was to help all rhubarb farmers in every way possible. The members of the association found that they could help the farmer members by purchasing packing facilities and by assisting them in obtaining a market for the rhubarb. The Internal Revenue Code exempts from income tax all labor, agricultural and horticultural organizations." The Code sec. 1426, sub-section (b), defines employment which is taxable, but expressly says that any service performed in the employ of an agricultural or horticultural organization is exempt from employment tax, if it is exempt from income tax under section 101 (1). Since the Sumner Rhubarb Co-operative is an agricultural or horticultural organization and is exempt from income tax under section 101 (1), then it is therefore exempt from social security tax. The whole question is as simple as that. The government says that the cooperative is not an agricultural or horticultural organization. To say this is pure and simple quibbling, but since the appellant is taking the matter

seriously it will be necessary for the appellee to show that the association is a horticultural or agricultural organization. According to volume 2, American Jurisprudence, page 395, section 2,

> "Agriculture, in the broad and commonly accepted sense, may be defined as the science or art of cultivating the soil and its fruits, especially in large areas or fields, and the rearing, feeding, and management of livestock thereon, including every process and step necessary and incident to the completion of products therefrom for consumption or market and the incidental turning of them to account. The term is broader in meaning than "farming"; and while it includes the preparation of soil, the planting of seeds, the raising and harvesting of crops, and all their incidents, it also includes gardening, horticulture, viticulture, dairying, poultry, and bee raising, and more recently, "ranching." It refers to the field, or farm, with all its wants, appointments, and products, as horticulture refers to the garden, with its less important, though varied products.
>
> Engagement by an agriculturist in another distinct business, either on or off his land, such as sawmill operations for hire or as a commercial enterprise, manufacturing for others, except simple processing of farm products, commercial mining, and logging and lumbering solely for the purpose of securing lumber, is usually held to be no part of the ordinary pursuit of agriculture, although such work may, in some circumstances and to a limited extent, be incidental to agriculture. The term "agricultural" has been defined as "pertaining to, connected with, or engaged in agriculture." A farm laborer, as ordinarily understood, is one who labors upon a farm in raising crops or doing general farm work.
>
> Although logically, such terms as "agricultural products," "farm produce," etc., would include

all things produced in the course of the pursuit of agriculture, their meaning, when used in tax or license statutes, is frequently dependent upon the context, or upon an express definition or limitation to a given class of products. Variously included under such statutes are both vegetable and animal products, including those of the field, garden, trees, orchards, livestock, poultry, eggs, dairy products, meats, nuts, and honey."

The Supreme Court of the State of Washington has defined agriculture in the following language: *Northern Cedar Co. v. French*, 131 Wash. 394, page 419.

"In its broad use it (agriculture) includes farming, horticulture and forestry, together with such subjects as butter and cheese making, sugar making, etc." Webster's New International Dictionary. "In a broad sense agriculture includes horticulture and forestry as well as what is ordinarily called farming." Nelson's Loose Leaf Encyc. The dictionaries and encyclopedias generally concur in the foregoing definition of agriculture. In *Maxwell v. Lancaster*, 81 Wash. 602, 143 Pac. 157, we said: "Horticulture is a branch of agriculture and can be included in an act relating to agriculture, without violating the rule which prohibits the union in one act of disconnected and unrelated matters."

The court's attention is called to the attitude taken by other courts and their tendency toward a broad construction of the term "agricultural labor" *Stromberg Hatchery v. Iowa Employment Security*, Com'n. 33 N. W. (2d) 498, syllabus 4.

"Salesmen, cullers, testers, office clerks, office manager, chick sexer, incubator watcher, incubator operator, and handyman who were employed by commercial poultry hatchery, and whose services were necessary to conduct and operation of such business, performed services in "connection with raising or hatching of poultry" so as to

be "agricultural labor" excluded from Iowa Employment Security Law, notwithstanding that not all such employees were actually engaged in manual process of incubating chicks. Code 1946, sec. 96.19, subd. 7, par. 8 (4)"

In its ruling as quoted from decision in case of *Birmingham v. Ruckers Breeding Farm*, 152 Fed. 2nd 837 (Internal Revenue) said:

> "It is held that the services of the employees of the M Company, which is engaged in the business of hatching chickens, can not properly be classified as 'agricultural labor' inasmuch as such services are commercial and are not performed as an incident to ordinary farming operations. The taxing provisions of the Social Security Act are therefore applicable."

The Court answers this and we quote:

> "That is the situation which existed when Congress, in 1939, undertook to define the term "Agricultural labor" and enacted the statute in controversy. Concededly, Congress was concerned with relieving agriculture of the social security tax burden by including in the term "Agricultural labor" certain services which had been held not to be exempt, but which were considered to be in reality an integral part of farming activities. See House Rep. No. 728, 76th Cong., 1st Sess. (1939)-2 Internal Revenue Cum. Bull., p. 538) and Senate Rep. No. 734, 76th Cong., 1st Sess. (1939-2 Internal Revenue Cum. Bull., p. 565).
>
> It seems clear that Congress, in defining "agricultural labor," used the broad language "services performed * * * in connection with the hatching of poultry" advisedly and in the realization that the burden of taxes imposed upon hatcheries which procured their eggs from farmers would have to be borne by agriculture. If Congress had intended that agriculture should be relieved of

this tax burden only to the extent of the taxes upon wages paid to those rendering services in the incubation of eggs, it would, we think, have selected appropriate language to express that intent."

Other cases which follow along the same lines are: *Miller Hatcheries v. Boyer*, 8 Cir. 131 Fed. 2nd, 383; *Walling v. Rocklin*, 8 Cir. 132 Fed. 2d 3. They all show that in taxation the law is to be construed in favor of those engaged in agricultural and horticultural work.

(b) Were the Manager and Clerical Worker for the Co-operative Exempt from Social Security Tax?

The appellant has contended that the co-operative was not a horticultural or agricultural organization and that therefore the only way the manager and clerical worker could be considered exempt from the social security tax would be by proving that they actually did agricultural labor. In other words, unless the employee of the Sumner Rhubarb Co-operative drove a truck, loaded and unloaded boxes of rhubarb or some other work in the process of which their hands would become dirty, then they were not agricultural workers. According to Webster, a definition of "organization" is "the act or process of forming organs or instruments of action." "Suitable discharge of parts which are to act together in a compound body." The only sensible construction of the taxation of employees of agricultural or horticultural operators who have formed an association would be to say that no matter what type of work was done, it was done for one purpose. In the case of the rhubarb cooperative, it was a united effort to benefit those who operated rhubarb farms. Each worker whether he be timekeeper, manager, secretary or common laborer in such a co-operative association, should be considered to do agricultural labor.

On page 83 of the transcript of record, Mr. A. J. Goettsch testified that he was acting as manager of the Rhubarb Growers Association during the taxable period in question here. He also said that sometimes he unloaded boxes of rhubarb from trucks and piled them on the platform of the Rhubarb Association's shed. He stated that he was paid as manager but that there was no distinction made as to the pay for the manual work he did and for other work done as the manager. If we follow the government's position to its ridiculous conclusion, Mr. Goettsch would be required to carry a stop watch so that his labor would be tax free while he was unloading boxes, and taxable as soon as he walked from the shed to the office and wrote down the number of boxes unloaded. The Commissioner of Internal Revenue must know that the legislature did not intend any such plan of taxation when the Social Security Act was written. Surely the Court will agree that the Rhubarb Association is an organization.

(c) The Record does establish that the Taxpayer was exempt from Income Tax under Section 101 (12) of the Code and that the services in question were exempt under 26 U.S.A., Sec. 1426 (h) (4)

Certainly the record before this court on review establishes that the taxpayer was and is exempt from income tax under section 101 (12) of the Code. On page 97 of the Transcript of Record I quote from the attorney for the Collector of Internal Revenue as follows: "Yes, on the proof they have made here I don't think there is any question about it. They are a co-operative marketing institution and they come exactly within the wording form 101 (12)." (Note the use of the word "institution" rather than "organization.")

In line with the government's reasoning heretofore, a marketing institution" would not be expressly exempt under section 101 (12) because co-operative marketing institutions are not mentioned. Following the reasoning further, and using the government's attorney's phrase "co-operative marketing institution," are we able to say that if we called our rhubarb co-operative an "institution" rather than an "association" we might be considered an organization exempt under 101 (1)?

THE LETTER FROM VICTOR H. SELF, Deputy Commissioner Internal Revenue, Plaintiff's Exhibit No. 1

The letter from the deputy commissioner internal revenue, dated June 24, 1948, recites that the Rhubarb Growers' Association was granted exemption under section 103 (12) of the Revised Act of 1928 (R. 45). Said section was in effect prior to section 101 (1) and it read word for word like section 101 (12) now reads. It is obvious that Congress had no intention of decreasing the special privileges granted agricultural and horticultural organizations under section 103 (12), but on the other hand, intended to increase the special tax exemption rights of agricultural and horticultural organizations by using such a broad exemption as, and I quote, "labor, agricultural or horticultural organizations." Merely because Congress carried the old section 103 (12) over, and called it 101 (12) should certainly not restrict the tax exemption rights of an agricultural or horticultural organization. If Congress had intended to except such agricultural or horticultural organizations as the Rhubarb Growers' Association from the general exemption 101 (1), then it would have done so in that section *Birmingham v. Ruckers Breeding Farm*, supra. It is reasonable, therefore, to say that it was the intention of the legislature to extend

rather than limit exemptions of agricultural and horticultural organizations by carrying over the old section 103-(12), and making it 101 (12). Just as in the case at bar and as shown by the letter from assistant commissioner Self, certain rights had been acquired by exemptions allowed such organizations as the appellee, and rather than run the risk of limiting or restricting, Congress carried over the old law in addition to adding the all-inclusive section 101 (1). The Social Security Act was still more recent and showed the kindly attitude of Congress toward the exemption of Agricultural or Horticultural organizations, but said Social Security Act provided that the service of anyone performed in the employ of an agricultural or horticultural organization, exempt from income tax under section 101 (1) should likewise be exempt from social security tax. The Commissioner of Internal Revenue forwarded to the appellant a letter enclosing forms of exemption affidavits to be made out and returned. (R. 45).

The letter does not use the phrase "exemption affidavit," but refers to it as being information which the association was requested to furnish to determine whether the association had been operating in such a manner as to entitle it to exemptions from federal income tax under section 101 (12). Because the association believed that the recent legislation entitled it to more exemptions than it had been allowed under section 103 (12), now 101 (1), it refused to sign the exemption affidavits binding itself exclusively to the rights and exemptions under section 101 (12). Since the government's demand was not immediately complied with the Commissioner of Internal Revenue, or some one or more of his agents, became irritated, and by letter of March 12, 1948, revoked appellee's exemption from income tax. To impress upon the court the arbitrary conduct on the part of the government agent,

we call to your attention the fact that the Commissioner of Internal Revenue did not have any information that the Rhubarb Growers' Association had changed its status or operation in any way from its operation since September 3, 1931, when the exemption from income tax was allowed under section 103 (12), now sec. 101 (12). Not only was the revocation to be a current penalty against the association, but it was also to be ante-dated and become effective as of January 1, 1939, (R. 46). You can imagine how inconvenient it has been to the association to fulfill the requests of the many Internal Revenue agents who have wanted to examine Association records for income tax determination for the years 1939, 1940, 1941, 1942, 1943, 1944, 1945, 1946, and 1947. All of this because the Department of Internal Revenue is provoked at the association for insisting upon the right to benefit from the broad exemption of section 101 (1).

(d) Services Here Involved Would Constitute Agricultural Labor Within the Meaning of the Statute, Sec. 1426 (h) Sub-Sec. 4

If by now the court is not convinced that the legislature exempt Rhubarb Growers' Association under the general exemption, then we must show that exemption of the employees under Social Security Act in the case at bar should be allowed because each of the employees was actually doing agricultural labor. In defining agricultural labor, section 1426, sub-section 1, 2, 3, use the phrase "in connection with." Paragraph 4 of said section 1426, sub-section (h) leaves out the words "connection with" and says that agricultural labor (exempt from social security tax) is such labor or services performed "in hauling, planning, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage or to market or to a

carrier for transportation to market any agricultural or horticultural commodity; but only if such service is performed as an incident in ordinary farming operations or, *in the case of fruits and vegetables, as an incident to the preparation of such fruits or vegetables for market.* The provisions of this paragraph shall not be deemed to be applicable to services performed in connection with commercial canning or commercial freezing or in connection with any agricultural or horticultural commodity after its delivery to a terminal market for distribution for consumption. (Italics supplied.)"

From the context the words "in connection with" are implied.

The purpose for which the association is formed and the operations which the Government admits by its letter, plaintiff's exhibit No. 1, makes the work of a manager and the office worker definitely an "incident in preparation of such fruits or vegetables for market." The appellant has called specific attention to that part of the Act which refers to terminal market for distribution for consumption. There is nothing in the facts of the case at bar which would place the appellee in the category of a terminal market for distribution for consumption. There is nothing in the facts of the case at bar which would place the appellee in the category of a terminal market for distribution for consumption. The handling, packing, storing and delivering to the market and to a carrier of the rhubarb was in each instance a service performed as an incident to the *ordinary farming operations* of a rhubarb grower. The boxes in which the rhubarb grower packed his rhubarb were furnished by the association (R. 68). The farmer packs the rhubarb in said boxes and trucks it to the warehouse rented by the appellee, which is a

clear-cut illustration of an incident to ordinary farming operation. The sale and shipping and storage for shipping are all incidents to the ordinary farming operations.

The Social Security Act is fundamentally not an act which was passed to include workers for seasonal operations. The evidence in this case definitely makes the operations of the appellee for th priod in question seasonal only, being operations in each year, carried on from January to May, or, approximately four months. (R. 69). Also your attention is called to the fact that most of the association's employees are high school boys who only work from 3:30 in the afternoon to 6:30 or 7:00 (R. 67). You will note on page 20 of the appellant's brief that certain decisions are referred to and listed under footnote No. 16, in which agricultural labor was defined, the cases being *Lake Regent Packing Association vs. United States*, 146, Fed. 2d, 157 (C. A. 5th); *Birmingham vs. Rucker's Breeding Farm*, (1945) supra; *U. S. Navar*, 158 Fed. 2d, 91 (C. A. 5th); *Lee Wilson & Co. vs. U. S.*, 171 Fed. 2d, 503 (C. A. 8th). The foregoing are cases in favor of the appellee, whereas the cases cited by the appellant in the body of its brief on page 20 are the cases which created the reason for Congress to correct the misunderstanding as to what was meant by "agricultural labor". *Birmingham vs. Rucker's Breeding Farm*, supra. Please re-read that portion of the Rucker case already set forth herein. Quoting from House Rep. 728, and Senate Rep. 734 (1939-2 Int. Rev. Cum. Bull, pages 543 and 560); in House Rep. 728 under the heading "definitions" appears the following explanation: (1939-2 Int. Rev. Cum. Bull, pages 552-553); Definition of agricultural labor under section 209 (1); 'The present law exempts

agricultural labor' without defining the term. It has been difficult to delimit the application of the term with the certainty required for administration and for general understanding by employers and employees effected. The committee believes that greater exactness should be given to the exception and that it should be *broadened* (italics is ours) to include as 'agricultrual labor' certain services not at present exempt, as such services are an integral part of farming activities. In the case of many of such services, it has been found that the incidents of the taxes falls exclusively upon the farmers, a factor which, in numerouse incidences, has resulted in the establishment of competitive advantages on the part of large farm operators, to the detriment of the smaller ones . . . "Paragraph 2 of the sub-section excepts services of the employee of the owner (whether or not such owner is in possession) or tenant of the farm in connection with the operation, management or maintenance of such farm, if the major part of those services are performed on the farm. Under this language, certain services are to be regarded as agricultural, even though they are not performed in conducting any of the operations referred to in paragraph 1. Services performed in connection with the operation, management, or maintenance of a farm may include, for example, services performed by carpenters, painters, farm supervisors, irrigation engineers, bookkeepers, and other skilled or semi-skilled workers whose services contribute in any way to the proper conduct of the farm or farms operated by their employer . . . ". From the foregoing it can easily be seen that Congress was not satisfied with the decisions rendered prior to the 1939 amendments. None of the cases which the appellant cites are in point. On page 22 of appellants brief, case of *Miller v. Berger*, 161 Fed. 2d 992, and *Miller v. Bettencourt*, 161 Fed. 2d, 995, are cited.

Those cases are set forth as facts, situations where the employer purchased fruit outright from the farmer, and the employment was in connection with a terminal market. In many places throughout the appellant's brief, Commissioner's rulings and Treasury regulations are recited as authority for forcing the Rhubarb Growers' Association to pay the social security tax. We don't admit that the rulings and regulations are binding on anyone, but the Internal Revenue agents; at the same time, however, it is interesting to note that if the Commissioner of Internal Revenue followed the regulations and rulings which are set forth in appellant's brief on pages 28, 29, 31, 33 and 34, this case would not now be before this court. Treasury regulation 111 promulgated under the Internal Revenue Code reads in part as follows: "Sec. 29.101 (1)-1. Labor, agricultural and horticultural organizations—the organizations contemplated by sec. 101 (1) as entitled to exemption from income taxation are those which—

> (1) Have no net income inuring to the benefit of any members.
>
> (2) Are educationl or instructive in character; and
>
> (3) Have as their object the betterment of the conditions of those engaged in such pursuits, improvement of the grade of their products and the development of a higher degree of efficiency in their respective occupations . . . "

The purpose and object of the Rhubarb Association is just exactly that which the Treasury regulation says should be an agricultural and horticultural organization, exempt from income tax. (R. 3) (R. 67) (R. 68).

Congress has defined agricultural labor, but section 402.208 of the Treasury regulation undertakes to do a

better job of defining the term "Agricultural labor." Sub-section (e) of the Treasury regulation defines agricultural labor as follows: "Service performed by an employee in the employ of a *farmer or a farmer's co-operative organization or group* in the handling, planting, drying, packing, packaging, processing, freezing, grading, storing or delivering to storage or to market or to a carrier for transportation to market of any agricultural or horticultural commodity, other than fruits and vegetables (see Sub-paragraph (2) below), produced by such farmer or farmers, members of such organization or group of farmers are excepted, providing such services are performed as an incident to ordinary farming operations.

Generally services are performed as an incident to ordinary farming operations within the meaning of this paragraph if they are services of the character ordinarily performed by the employees of a farmer or of a farmer's co-operative organization or group as a prerequisite to the marketing in its unmanufactured state of any agricultural or horticultural commodity produced by such farm or by the members of such farmer's organization or group . . . "

The Internal Revenue Department, if it followed the terms of the last regulation of the Treasury Department, would never have forced the appellee to go to court. Is not the Sumner Rhubarb Co-operative a "farmers' cooperative organization or group?" The packing and boxing of the rhubarb is a prerequisite of marketing it. All of the rhubarb for which the appellee furnished the boxes was produced by members of the co operative. Now to make the government's position still more incongruous let's look at sub-paragraph of said sub-section (e).

"(2) Services performed by an employee in the employ of any person in the handling, planting, drying, packing, packaging, processing, freezing, grading, storing or delivering to storage to market or to a carrier for transportation to market of fruits and vegetables, whether or not of a perishable nature, are excepted as agricultural labor, providing such services are performed as an incident to the preparation of such fruits and vegetables for market. For example, if services in the sorting, grading or storing of fruits, or in the cleaning of beans are performed as an incident to their preparation for market, such services may be excepted, whether performed in the employ of a farmer, a farmer's co-operative, or a commercial handler of such commodities." This would very definitely place the Sumner Rhubarb Co-operative employees within the exemption. (R. 35).

Sub-section 3 of the Treasury regulation unreasonably cuts down the exemption allowed in sub-sections (1) and (2). From what the appellee has shown thus far, it can be seen that the regulation which makes a distinction such as the sub-sections of said Treasury regulation is arbitrary and without any constructive reason. The Rucker case didn't follow it, but in fact threw it out.

The Treasury regulation goes so far as to say that the Federal Statute should not be given its express intent. The regulation says in part, "Moreover, since the excepted services described in such sub-paragraphs must be rendered in the actual handling, planting, drying . . . or delivering to storage or to a market or to a carrier for transportation to market, of the commodity, such services do not for example include services performed by stenographers, bookkeepers, clerks and other office employees, *even though such services*

may be in connection with such activities. Which is to prevail, the Treasury regulation or the Federal Statute?

In conclusion and to summarize:

1. The Sumner Rhubarb Growers' Association is an agricultural or horticultural organization, exempt under Revenue Code Sec. 101 (1) from income tax and is therefore exempt from social security tax.

2. The Sumner Rhubarb Growers' Association, if it so desires, may claim its exemption from income tax under Internal Revenue Code 101 (12).

3. If the association obtains exemption under sec. 101 (12) then its employees are all furnishing service exempt under section 1426 (h) (4) of the Social Security Act.

The decision of the District Court should be affirmed.

Respectfully submitted,
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